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SUBJECT: The Japan Economic Scope--August 9, 2007

11. (U) This cable contains the Japan Economic Scope from August 9,  
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13. (SBU) LDP's Political Foundation Has "Crumbled," Says One  
Pundit

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The Upper House elections on July 29 represented the most severe  
defeat for the LDP ever. "The party's political foundation has  
crumbled."

That was how Minoru Morita, a long-time political analyst in  
Tokyo, described the results during a talk at the American  
Chamber of Commerce in Japan (ACCJ) on August 8 that we attended.

Morita inventoried the LDP's past defeats in Diet elections -- in  
1983, 1989, 1993 (when the party slipped into the opposition for  
nine months), 1996 and 1998, and asserted that no defeat was as  
devastating as this one.

In the past, Morita said, the LDP found ways to hive off elements  
of the opposition to hang onto power. This time the defeat was  
so complete that the party is hamstrung.

Revenge of the Farmers?

Morita pointed to the profound erosion of support for the LDP in the rural areas of Japan, where jobs are disappearing and farmers are hurting, as the core reason for the LDP's landslide defeat. People are blaming the structural reforms of the Abe government, Morita said. They point to the "heartless" way the party has written off Japan's inefficient farm sector as proof that the LDP is out of touch.

The reforms the LDP has implemented in the farm sector, Morita asserted, are seen as draconian, akin to something out of Thomas More's "Utopia," or more aptly, Stalin's campaign against Russia's private farmers.

Somewhat implausibly, Morita said that any perceived support of rural areas for former Prime Minister Koizumi could be viewed in hindsight as a "plea for help." (In fact, results from the 2005 Lower House elections show that Koizumi had already lost substantial rural support.)

Next Elections

Morita suggested Lower House elections could come earlier than expected, as early as this fall or by next summer. The biggest question for the DPJ, he said, will be the health of party leader Ozawa.

For the LDP's part, Morita said the party's only plausible strategy will be to try to hive off part of the opposition to its side.

A big worry of Morita's is that the LDP's political demise could

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come "too fast." Japan could go from a one party system under the LDP to a one party system under the DPJ. (ECON: Nicholas Hill)

14. (SBU) Postal Privatization, Other LDP Legislative Initiatives,  
Up for Review?

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The Democratic Party of Japan (DPJ) and other opposition parties have been meeting to discuss bills they will want to submit during an extraordinary session of the Diet set to open at the end of August.

According to press reports, the opposition was set to submit a postal privatization amendment bill in the Upper House on August 9 and planned to resubmit it again at the extraordinary session later. (We have not seen the bill posted online as of yet.) We talked to a couple of sources in the U.S. industry who were not familiar with the details nor appeared too concerned, at least at this stage. No bill on postal privatization could pass in the Lower House.

Trying to slow down Japan Post privatization is a priority of the People's New Party (PNP), a DPJ coalition partner. The party features a coterie of former LDP dinosaurs expelled from the LDP by former PM Koizumi.

A DPJ staff member told us that the party held a shadow cabinet meeting on August 8, and the leadership was divided on whether to join the PNP on the bill.

The internal DPJ debate hinged on the bad politics of backing an effort that had been so soundly repudiated in the 2005 Lower House elections.

The source acknowledged that the party would have to be more careful about what bills it submits in the Upper House.

As the majority in the Upper House, the DPJ will be expected to articulate more clearly what it is doing in crafting legislation.

Most of the party's policy heavy weights, including Takeyaki Matsumoto, the DPJ's Policy Research Committee Chair, are Lower House members. (ECON: Nicholas Hill)

#### 15. (SBU) Beef Talks Grind Down, No Consensus Yet

Expert-level talks between the United States and Japan on Japan's onerous restrictions on U.S. beef imports concluded August 3 with no consensus yet on what the next step should be.

At an August 7 press conference, Acting Agriculture Minister Wakabayashi indicated that Agriculture Secretary Johanns has asked Japan to remove all age restrictions on U.S. beef imports. The two spoke by telephone on August 6.

The Japanese side has indicated that it would recommend to its independent Food Safety Commission that restrictions on beef from under 30 months be lifted.

The two sides continue to discuss the issue. The United States would like to see Japan move toward science-based international standards for beef as identified by the World Animal Health Organization (OIE).

According to a Jiji report, Wakabayashi indicated that Japan would make a decision after it reviews more carefully the information provided by the United States concerning the feed controls it currently has in place.

In a related development, a Canadian expert-level team was in Tokyo for talks on August 8. (ECON: Nicholas Hill)

#### 16. (U) Japan and China Discuss Food Safety

Following up on agreement reached last month, China and Japan held discussions on food safety in Beijing on August 6.

According to a Nikkei report, the two governments agreed to continue an information exchange.

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In addition, Japan will transfer technology to help measure pesticide residue levels and other toxic materials, and seek to streamline China's quarantine procedures put in place after China's recent food safety problems came to light.

Hideshi Michino, Director of Japan's Health Ministry's Office of Food Import Inspection and Safety, led the GOJ delegation.

Michino has been the point person for Japan in expert talks with the United States on BSE. (ECON: Nicholas Hill)

#### 17. (SBU) Upper House Election Complicates Economic Decision making

The defeat Japanese voters handed the ruling Liberal Democratic Party (LDP) on July 29 stems primarily from domestic concerns the Diet will have to take up when it reconvenes in the autumn.

For an outline of Embassy expectations for these issues, a brief discussion of the future of the Council for Economic and Fiscal Policy, reactions of investors and key business leaders, and an explanation of the mechanics for passing legislation, please see Tokyo 3660 (ECON: Joan Siegel)

#### 18. (SBU) Trade Policy Limbo?

A cast of speakers from government, academia, and business presented a mixed picture of Japan's trade policy at a symposium on August 6 in Tokyo sponsored by the Research Institute for Economy, Trade and Industry (RIETI).

An Economics professor at Tokyo University, Akira Kotera, said he did not see a Doha multilateral trade deal getting done before 2010.

Kotera pointed to the political reality in the United States, including presidential elections and a Congress reluctant to continue extending fast track trade promotion authority. The professor added that WTO members such as India could "stall" the talks again by making more demands in the services negotiations.

A Trade Ministry (METI) official professed to be more optimistic. Naoshi Hirose, Director of the Multilateral Trade System Department, told the audience he hoped a deal could be struck before year-end.

The draft modalities papers for the NAMA and agriculture talks may actually provide an impetus for progress, Hirose asserted, precisely because so many countries seem to be "equally dissatisfied" with them.

Kazayuki Kinbara, representing the Japan Business Federation (Keidanren) was dour about the slow pace of the Doha negotiations.

He said Japan's business community would be willing to accept a "bad" deal just to get it done.

On the impact of the recent Japanese elections, speakers said that the LDP and DPJ shared similar views on trade policy. Shigehiro Tanaka, Director for FTA affairs at METI, said that the government continued to make good progress on negotiating bilateral deals, particularly considering the human resource constraints the bureaucracy faces.

RIETI is a quasi-public think tank funded primarily by METI. The papers for the conference will be uploaded on to the RIETI website in the next two weeks. (ECON: Nicholas Hill/Ryoko Nakano)

#### 19. (U) METI Extends Byrd Countermeasures

Japan will continue sanctions against the United States in retaliation for the Byrd Amendment which the United States repealed last year, but has not been completely phased out. According to the Trade Ministry website, the countermeasures will be extended beyond September 1 after they receive formal approval at an August 10 cabinet meeting.

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The Finance Ministry's (MOF) Council on Customs, Tariffs, Foreign Exchange, and Other Transactions recommended the extension when it met earlier this month.

From a review of the MOF Japanese language website, the commodities covered and tariff rates will basically remain the same as in the past.

According to METI's announcement, the countermeasures will continue beyond September because commodities cleared by U.S. customs before October 1, 2007 would continue to be subject to allocation under a transitional provision of the February 2006 legislation that repealed the Byrd Amendment. (Click here for the press release in Japanese.)

The MOF website indicates that the countermeasures will end when the U.S. carries out the WTO recommendations related to the Byrd amendment. For more information (in Japanese) click here. (ECON: Ryoko Nakano)

#### 10. (SBU) Former House Speaker Hastert Visits Nuclear Power Facilities

During an August 5-9 visit to Japan, J. Dennis Hastert, former Speaker of the House of Representatives and now ranking member of the House Energy and Commerce Committee, toured the Rokkasho nuclear fuel reprocessing facility in Aomori Prefecture and the MONJU breeder reactor near Osaka. In Tokyo, Hastert also met with Defense Minister Yuriko Koike, and several leading LDP Diet members including Acting LDP Secretary General Nobuteru Ishihara and Lower House Speaker Yohei

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Kono. (ECON: Chris Wurzel)

11. (U) JETRO Notes Record FDI Outflow, Examines FTA Strategy: -

In its annual trade and investment white paper released on August 8, the Japan External Trade Organization (JETRO) reports that Japan's outward foreign direct investment grew 10.3 percent year-on-year to reach \$50.2 billion in 2006, setting a new record.

In contrast, net inward FDI was negative \$6.8 billion, the first net outflow since 1996, as Japanese firms made major acquisitions of foreign-invested assets in Japan. The report also analyzes Japan's free trade agreement/economic partnership agreements strategies and concludes that agreements that extend beyond simple tariff reductions and include non-tariff barriers that contribute to higher transportation and service costs have yielded the greatest economic benefits in the Asia-Pacific region.

(ECON: Chris Wurzel)

12. (U) Cabinet Office Calls for Higher Productivity Growth, Use of M&As

In the 2007 Cabinet Office Annual Report on the Japanese Economy and Public Finance, the government of Japan called for measures to address the phenomena of rising income inequality during a period of economic growth.

Titled, "Toward Higher Productivity Growth", the white paper argued that the increasing disparity was due in part to globalization and the increasing proliferation of information technology.

"This report highlights the structural problems of the Japanese economy," explained Economic and Fiscal Policy Minister Hiroko Ota. Recognizing that not only have income differences in major firms between permanent and temporary employees been growing, but also that temporary workers with lower wages now account for one-third of the country's total workforce

The report suggests fiscal and social security measures to resolve growing disparities. It urges the government to reconsider the current system of wealth redistribution, including social security benefit payments and income tax deductions. The Cabinet Office's views on M&A activity stand in sharp relief to recent comments to the contrary by METI officials. (FINATT: Mateo Ayala)

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13. (SBU) Capital Investment Booming in Kansai

According to a recent study by the Kansai Branch of the Development Bank of Japan (DBJ), the estimated amount of capital investment in the Kansai's six prefectures for FY2007 was 2.3 trillion yen. The amount represented a 20.6 percent increase from the previous year and was the highest growth rate among the other nine districts in Japan.

Hyogo Prefectural Officials commented that the local economy will be significantly affected by these enormous investments. Since Matsushita started operating in Amagasaki city, nearby vacant industrial sites are quickly being bought up with all sites

likely to be sold out within the year.

The businesses purchasing these sites are not only sub-contractors, but also printing services and small gas companies that do business with Matsushita. Osaka Prefecture officials are expecting similar results with Sharp's new plant in Sakai city. (Osaka-Kobe: Scott Ravenhill/Naomi Shibui)

¶14. (SBU) Central Japan Economy Plateaus  
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The Central Japan heads of METI and the Bank of Japan told the Principal Officer that regional growth appears to be leveling off, but that should not have too much of a negative effect on the national economy.

Nagoya-area companies have invested heavily to increase production in other parts of Japan, and the Central Japan economy itself continues with stable growth, in part due to immigrant labor.

Nevertheless, regional disparities continue to worsen, and are likely to become even more severe with the aging of Japan's population and the LDP's historic shift away from massive subsidies to rural areas -- a policy change that cost the party dearly in the recent Upper House election. For more information, see Nagoya 0034. (Nagoya: Dan Rochman)

¶15. (U) Chicago Firm Opens its First Overseas Office in Nagoya  
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Chicago Powdered Metal Products Company (CPM) of Illinois, a family-owned SME with annual sales of approx. \$35 million, officially opened its first overseas office in Nagoya, Japan on August 6.

CPM uses unique powdered metal technology to produce high-tech auto parts for GM, Ford, and increasingly Japanese firms. Its Asia office will allow CPM to design-in products for assembly in Japanese auto plants worldwide by providing local technical and sales support directly to headquarters decision-makers in Japan, as well as allow it to expand into the global aerospace market. Nagoya is the center of Japan's manufacturing base and hosts the headquarters and main plants of auto behemoths such as Toyota, Denso, Aishin, Suzuki, and Honda -- and aerospace giants Mitsubishi, Fuji, and Kawasaki Heavy industries.

CPM's Japanese manager is a long-time FCS contact. At an August 6 reception marking CPM's Nagoya launch, he noted the Consulate's support as one factor in CPM's decision to open a Nagoya office. (FCS Nagoya: Edward Yagi)

¶16. (U)JAL Stronger 1st Quarter, Flight Changes, and Cargo Tie-ups  
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Japan Airlines, which is in deep financial trouble, announced on August 6 a stronger 2007 first quarter as compared to the same period last year. Revenues declined slightly from the year before, but expenses declined considerably more, the result, JAL claims, of the company's restructuring efforts, making for a better showing than the year before.

The Japanese press reports that JAL's major banks are still skeptical and awaiting the results of JAL's second quarter. JAL on August 3 projected its passenger traffic for the mid-August vacation season with a 1.5 percent increase in international

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passengers over the year before and a three percent decline in domestic passengers.

JAL on August 7 revealed further revisions to its international routes particularly in Asia to focus on high profit, high growth routes, including flights from China that carry on to the United States via Narita.



This week the press reported that JAL would tie-up with two of Japan's leading distribution companies, Nippon Express and Kintetsu Express, to create an international small-package delivery network.

The goal is to compete with DHL, FedEx and UPS for the outbound Japanese market aiming to achieve a 30 percent market share on par with DHL, the market leader. JAL has not made a formal announcement about the tie-up, but the news has resulted in rise of share prices of three companies. For further reading, see press releases on JAL's website. (ECON: Junko Nagahama/Josh Handler)

¶17. (SBU) KIX Plans for Future after Opening 2nd Runway  
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Currently operating as a 24-hour airport after the August 2 opening of a second runway, Kansai International Airport Company (KIAC) President Atsushi Murayama has set his sights on making Kansai International Airport (KIX) profitable by accelerating the promotion of cargo business.

Murayama believes the recent decision by ANA to shift its cargo business from Chubu to KIX and a JAL announcement stating it will be increasing its cargo flights out of KIX are steps in the right direction. In addition, a KIAC official mentioned that increasing trade with Russia has caused Aeroflot Russian Airlines to consider operating direct cargo flights between KIX and Moscow or St. Petersburg in the near future.

In contrast to cargo business, KIX is still struggling to improve its passenger flight business. According to a Kansai Economic Federation (Kankeiren) announcement last week, member companies are encouraging its employees, not just its executives, to purchase business class seats on business trips from KIX. (Osaka-Kobe: Scott Ravenhill/Naomi Shibui)

¶18. (U)MLIT Preparing New Airport Legislation?  
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Following on the work done in the last year by Ministry of Land, Infrastructure and Transport's (MLIT) Airport Discussion Group and Aviation Subcommittee (see Tokyo 2180, May 15, 2007), MLIT has created a study group to examine the future of Japan's airports with the goal of submitting items for legislation in the fall session of the Diet.

Specific issues to be considered include legislation for Itami airport in Osaka and improvements in international airport management, a topic which was not covered in the Airport Discussion Group.

The study group comprises virtually all the committee members from the previous Airport Discussion Group as well as Shizuoka governor Ishikawa, Tokyo University Prof. Kanemoto, CEO from TV Osaka Tomizawa, and Gifu University Prof. Takeuchi. Details of the first meeting are not yet available. (ECON: Junko Nagahama)

¶19. (U) MLIT Studying Simplifying Port and Harbor Procedures  
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As a result of Prime Minister Abe's May 16 Asia Gateway Initiative report, the Ministry of Land, Infrastructure and Transport (MLIT) established a study group to examine simplifying port and harbor procedures.

The study group held its first meeting on July 30, and will be looking at using IT and paperless processes to streamline port procedures for the Next Generation Single Window system as is called for in the Asia Gateway Initiative under its Trade Procedure Reform Program.

At the first meeting, members agreed to work closely with the

Ministry of Economy, Trade and Industry (METI) with which MLIT is already working on a Partnership Program for Competitive International Distribution.

The group's goal is to expand and facilitate trade with East Asian countries, and with the Ministry of Finance, which is developing the Next Generation Single Window system. The next study group meeting will be held in October. (ECON: Junko Nagahama)

¶20. (SBU) Japan Export Controls Officials to Help Other Countries' Officials in Asia  
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The Trade Ministry's (METI) Export Controls division is creating a pilot program of outreach to other countries in the region. Representatives of the Export Controls division told us on August 3 that will visit other major cities in Asia to share information the GOJ has on possible export controls violations. They plan to share with their counter parts observations concerning methods used by companies that are attempting to skirt export controls. This program is an extension to a change in Japan's laws. In accordance with UN Security Counsel Resolution 1540, the GOJ passed in to law on June 1 a regulation making it illegal for any Japanese company to broker a trade or provide logistical support for transshipment of dual use items without appropriate METI approval and the corresponding license.

Prior to June 1, Japanese law enforcement authorities only had jurisdiction if the products were shipped from Japan. Nonetheless, Japanese police and prosecutor's office have brought to trial several cases for violating export controls. Officials are pleased with the change in the law that provides a necessary legal mechanism to continue increasing oversight of export controlled items. For related story, take a look at Tokyo 03590. (ECON: Charlie Crouch)

¶21. (U)Treatment of Digital Content - Public Comment Announcement  
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MIC announced a public comment period, until 14 September, on a report entitled "Toward Promotion of Digital Content Distribution."

The advisory panel report includes proposals for "Internet Policy of the 21st Century" and "Administrative roles to be played toward an expansion of application/usage of terrestrial digital broadcast."

The draft report also deals with copyright related issues such as secondary usage of broadcast programs and movies and original programs of IP multicast. For example, the report recommends loosening existing rules allowing only one-time copying of digital programming, to allow copying up to 10 times.

The 94-page report is divided into two chapters: Ways to control copies of digital broadcast (deals with "copy once" issues); and Development of content transaction markets and specific measures toward vitalization of transactions (deals with IP multicast and related issues).

Click here to access the report along with the public comment announcement in Japanese. (ECON: Scott Smith/Kaoru Nakata)  
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